



December 3, 2012

Via Electronic Submission

Office of Strategic Initiatives
Federal Housing Finance Agency
400 Seventh Street SW, Eighth Floor
Washington, D.C. 20024

RE: Building a New Infrastructure for the Secondary Mortgage Market

Ladies and Gentlemen:

The American Securitization Forum (“ASF”)¹ is submitting this letter in response to the request of the Federal Housing Finance Agency (“FHFA”) for input regarding your White Paper entitled “Building a New Infrastructure for the Secondary Mortgage Market” (the “White Paper”).² ASF was founded as a means to provide industry consensus on market and regulatory issues, and we have established an extensive track record of providing meaningful comment to various regulatory agencies on issues affecting our market. Our views as expressed in this letter are based on feedback received from our broad membership of primary and secondary mortgage market participants.

The White Paper addresses the need to establish a single platform for the future issuance of all residential mortgage-backed securities (“RMBS”) that are guaranteed by Fannie Mae (“Fannie”) and Freddie Mac (“Freddie”, and collectively with Fannie, the “Enterprises”), both during the remainder of the conservatorship period and thereafter, including a standardized form of pooling and servicing agreement (“PSA”). The White Paper also raises the question of whether this single platform should be designed to accommodate issuances of RMBS by private sector entities (“Private Label Securities” or “PLS”). This letter sets forth ASF’s views with respect to FHFA’s proposals and their application to fully guaranteed Enterprise securitizations, Enterprise risk sharing securitizations and PLS.

¹ The American Securitization Forum is a broad-based professional forum through which participants in the U.S. securitization market advocate their common interests on important legal, regulatory and market practice issues. ASF members include over 330 firms, including issuers, investors, servicers, financial intermediaries, rating agencies, financial guarantors, legal and accounting firms, and other professional organizations involved in securitization transactions. ASF also provides information, education and training on a range of securitization market issues and topics through industry conferences, seminars and similar initiatives. For more information about ASF, its members and activities, please go to www.americansecuritization.com.

² See <http://www.fhfa.gov/webfiles/24572/FHFASecuritizationWhitePaper100412FINAL.pdf>.

Executive Summary

ASF supports the development of a single securitization platform with a model PSA for fully guaranteed securitizations issued by either Fannie or Freddie. We see benefits at each level of the single securitization platform in this context, including standardization of certain of the Enterprises' operations and creation of efficiencies by permitting lenders to employ a standard interface to both Fannie and Freddie.

We also support the use of the single securitization platform for Enterprise risk sharing transactions, using either a senior/sub or a synthetic structure. However, it is important to note that once the Enterprises depart from a fully guaranteed model and offer credit risk, the investor base for non-government guaranteed portions will shift from rates investors to credit investors. Credit investors in an Enterprise risk sharing transaction will likely seek many of the same protections as those sought by investors in PLS, including an independent trustee, different enforcement mechanisms for representations and warranties, more robust disclosure and pre-issuance due diligence. Proposed changes in federal securities laws could also mandate more granular disclosure and reporting requirements for subordinate first loss classes, including extensive loan-level data. The potential effect of this loan-level disclosure on TBA eligibility for the senior classes in a senior/sub structure should be carefully considered.

The White Paper envisions that the single securitization platform could potentially be utilized by the PLS market, and FHFA has indicated that the platform could potentially be sold to the private market as a public utility. Additionally, risk sharing transactions bring about issues that also exist in PLS, as part of the structure would be sold to investors without a guarantee. For these reasons, we provide an overview of current factors inhibiting a robust PLS market, industry efforts to restart the PLS market through ASF Project RESTART and a description of how PLS securitization differs from Enterprise securitization.

We articulate some of the primary factors that, in the aggregate, have contributed to the slow pace of the PLS market recovery. First, guarantee fees and conforming loan limits continue to be set at a level that gives Enterprise securitization an execution advantage as compared to a PLS transaction. Second, there is broad and deep regulatory uncertainty that particularly affects the ability of issuers to set up vibrant PLS programs. The market impacts of yet-to-be-issued rules regarding ability-to-repay and qualified mortgage, risk retention and qualified residential mortgage, Regulation AB II and Basel III cannot be discerned or understood. This uncertainty impairs deployment of the private capital needed to develop platforms and infrastructure to support redeveloping PLS markets. Moreover, these regulations, particularly risk retention, will impose substantially greater compliance and economic burdens on PLS, as compared to fully guaranteed Enterprise securitizations during conservatorship. Third, continued uncertainty with respect to the future of the Enterprises makes it difficult for private market participants to determine the extent to which PLS may play a role in the future U.S. mortgage market.

One of the potential benefits of the securitization platform proposed in the White Paper is standardization. The PLS markets are already engaged in substantial efforts in this regard. Our letter discusses the efforts of PLS market participants over the last 5 years to develop standards and best practices, through ASF's Project RESTART, in the areas of loan-level data, representations and warranties, model repurchase principles and bond-level reporting. However, our work on Project RESTART confirms our belief that while there is a desire among PLS market participants for model standards and practices on specific topics, wholesale standardization of offering and operative documentation for PLS is likely not feasible.

There are a number of reasons why disclosure documents and PSAs for PLS securitizations vary from issuer to issuer, and to a lesser extent for any specific transaction. If credit risk is sold rather than guaranteed, the incentives among transaction parties shift, and individual determinations of contractual and securities law liability result in non-standard transactions that have differences in structure, governance and disclosure. For example, stronger and more certain representation and warranty enforcement mechanisms are being developed by PLS market participants in new transactions. Market participants need latitude to develop these provisions over time through negotiations, in order for consensus and accepted best practices to emerge. Another example is the high level of compliance obligations and potential liabilities that PLS issuers face under federal securities laws, which are not applicable to fully guaranteed Enterprise securitizations. For these reasons, the role of a PLS issuer is not a "service" function, but rather a principal role that requires the issuer to have substantial control over disclosure and operative documents.

Finally, there would need to be sufficient incentives for PLS market participants to use the single platform proposed under the White Paper. Key elements of the platform that are advantages for Enterprise securitizations, such as standardization, may actually be disincentives for PLS market participants to use the platform given the variability that comes with selling credit risk. The need for PLS issuers to have flexibility in order to manage their securities law and contractual liability risks would also be a disincentive to using the platform. Potential cost savings alone may not be a sufficient countervailing incentive for use of the platform. However, it is possible that some future form of government-sponsored enterprise involvement in the housing markets could create incentives for PLS issuers to use the single platform, depending on the particular features of that structure.

I. Comments related to Enterprise Securitizations

FHFA proposes to develop a single securitization platform and a model PSA to be utilized by the Enterprises in both fully guaranteed and risk sharing securitizations. FHFA believes that maintaining the efficient flow of mortgage credit requires upgrading the existing "antiquated and inflexible" Enterprise infrastructures and providing a more flexible infrastructure than is

currently available to accommodate future housing policy decisions.³ In that vein, the single securitization platform is intended to “(1) replace the outmoded proprietary infrastructures of the Enterprises with a common, more efficient model; and (2) establish a framework that is consistent with multiple states of housing finance reform, including greater participation of private capital in assuming credit risk.”⁴ As set forth in the White Paper, the platform would perform standardized services across both Enterprises including data validation, issuance, disclosures, master servicing and bond administration. The model PSA is intended to create greater consistency as to key contractual features, which FHFA believes will provide a more stable, liquid and efficient secondary market.⁵

In the context of fully guaranteed Enterprise securitizations, ASF supports FHFA building a single securitization platform that standardizes certain of the Enterprises’ operations and allows lenders to employ a standard interface to both Fannie and Freddie. We see benefits at each level of the single platform for fully guaranteed Enterprise securitizations. Standardization of loan delivery interfaces and data validation will create efficiencies for lenders and help ensure that a lender’s choice to deliver loans to either Enterprise is not needlessly influenced by largely administrative procedures between the lender and the Enterprise. The standardization of disclosure and reporting, in particular if it were based on current market and regulatory efforts, would create efficiencies across the market and ensure that each Enterprise was distributing robust data to investors. Finally, updating software and infrastructure that is outdated will ensure that Enterprise securitization continues to be a seamless and efficient process. ASF also supports the development of a model PSA, which will standardize contractual and governance provisions between the Enterprises. We believe the standardization afforded by a single securitization platform and model PSA will ultimately result in substantial efficiencies and reduced costs, and in connection with other efforts by FHFA to further standardize and align business practices of the Enterprises, potentially offer comparable security performance.

We highlight, however, that such a wholesale standardization is made possible by the implicit government guarantee provided by the Enterprises, which incentivizes lenders and investors alike to utilize the Enterprise model in its prescribed form. As we discuss below, if the guarantee is eliminated and credit risk is sold in a risk sharing securitization, the incentives among lenders and investors will be altered, and individual determinations of contractual and securities law liability may lessen the Enterprises’ ability to impose standard terms and documentation. So, while ASF also supports utilizing the single platform in risk sharing securitizations, we believe the considerations set forth in Section I.B. below are important for FHFA to take into account.

³ White Paper at 4.

⁴ White Paper at 2.

⁵ White Paper at 14.

A. Fully Guaranteed Enterprise Securitizations

ASF supports the development of a single securitization platform for fully guaranteed transactions by either of the Enterprises in their current state of conservatorship. This view is consistent with the general theme set forth in our July 2, 2012 discussion paper entitled “Discussion of a Proposed Single Agency Security” (the “ASF Discussion Paper”)⁶ that was released in response to the Strategic Plan⁷ issued by FHFA in February 2012. The Strategic Plan proposed, among other things, to build a new infrastructure for the Enterprises, including the development of the single securitization platform that would “allow for a single mortgage-backed security.”⁸ The ASF Discussion Paper sought to provide FHFA with (i) information and context concerning the pricing inefficiencies that currently exist in the to-be-announced (“TBA”) market for Fannie Mae Mortgage-Backed Securities (“MBS”) and Freddie Mac Participation Certificates (“PCs,” and together with MBS, “agency securities”) and (ii) industry views on the potential implementation of a unified agency security (the “Single Agency Security”).

While we understand that FHFA does not consider the Single Agency Security to be a priority at this time,⁹ its White Paper endeavors to further align the operations of the Enterprises through a single securitization platform and a model PSA, which are two of the steps recommended in the ASF Discussion Paper to minimize the pricing inefficiencies that currently exist in the market. We also note that FHFA and the Enterprises have undertaken a number of other initiatives to further standardize and align business practices, including the Uniform Mortgage Data Program, the Servicing Alignment Initiative, the Joint Servicing Compensation Initiative, the Loan-Level Disclosure Initiative and the Representation and Warranty Framework.¹⁰ While the specifics of each of these initiatives can be debated, we continue to support actions that standardize and create efficiencies across Fannie Mae and Freddie Mac, as previously described in the ASF Discussion Paper. We believe such actions will help align the characteristics of agency securities and promote consistent performance, which will help eliminate the differing perceptions about Fannie Mae MBS and Freddie Mac PCs and lead to similar pricing. Additionally, FHFA and other regulators indicated during meetings on this issue that additional information about market pricing was desired. Set forth below is an updated discussion of the market inefficiencies that currently exist in the TBA market, which we believe will be helpful to FHFA and the Enterprises as they implement many of the initiatives outlined in their White Paper.

⁶ See http://www.americansecuritization.com/uploadedFiles/ASF_Single_Agency_Security_White_Paper_2012.pdf.

⁷ See “A Strategic Plan for Enterprise Conservatorships,” February 21, 2012 (the “Strategic Plan”), at <http://www.fhfa.gov/webfiles/23344/StrategicPlanConservatorshipsFINAL.pdf>, which was incorporated into FHFA’s broader “Strategic Plan: Fiscal Years 2013-2017” on May 14, 2012.

⁸ Strategic Plan at 13.

⁹ See “The Conservatorships of Fannie Mae and Freddie Mac: An Update on Current and Future Operations,” Edward J. DeMarco, Acting Director, Federal Housing Finance Agency, at 9, <http://www.fhfa.gov/webfiles/24365/2012DeMarcoNCSpeechFinal.pdf>.

¹⁰ White Paper at 28-29.

As detailed in the ASF Discussion Paper, the secondary mortgage market values Freddie Mac and Fannie Mae securities differently, despite FHFA's conservatorship of both entities and the U.S. Government's provision of unlimited support through the end of 2012. Freddie Mac pools historically have traded at a discount to Fannie Mae pools, and Freddie Mac traditionally has made up for this discount by providing loan sellers a lower guarantee fee or other concessions, including a "market adjustment payment" that normalizes the pricing differential.¹¹ This differential exists despite the fact that, other factors being held equal, Freddie Mac PCs should actually trade at a premium to Fannie Mae MBS because PCs remit monthly payments of principal and interest 10 days earlier than MBS. Despite this payment advantage, the pricing of Freddie Mac PCs suffers from prepayment and liquidity concerns that far outweigh the premium afforded by earlier monthly remittances. Recently, the pricing differential between Freddie Mac PCs and Fannie Mae MBS has widened even further, causing concern among market participants. This widening has occurred across the existing coupon stack, with securities featuring higher coupons experiencing a wider spread.¹² For a look at the change in spread over time across all coupons, please see the tables in Exhibit I. A look at the two main causes of the pricing discrepancy—prepayment speed and liquidity—provides additional context.

1. Prepayment Speed

As agency securities are purchased at a substantial premium in today's low interest rate environment, an earlier-than-expected return of principal due to prepayments on the underlying loans will greatly decrease the yield on such securities and force investors in the securities to reinvest the returned principal at lower interest rates. As such, a perception that an agency security will have a relatively higher prepayment speed will negatively impact the price of such security.

A loan's prepayment speed can be impacted by a variety of factors other than interest rates, including, among many other things, loan underwriting and refinance programs. In terms of loan underwriting, the more creditworthy a borrower is, the more likely the borrower will be able to refinance his or her loan. For example, a borrower with a 760 credit score and a 65% LTV is a more attractive refinance candidate for lenders (other factors being held equal) than a borrower with a 720 credit score and an 85% LTV. A more creditworthy borrower may also be more inclined to refinance if the borrower is more sophisticated and quicker in reacting to changes in rates and refinancing offers, in particular if the loan size is large and the potential savings greater. Not surprisingly, refinance programs themselves will have substantial impacts on

¹¹ See <http://www.fhfa.gov/webfiles/22642/2011GFeeReportFinal.pdf> at 17. Because these incentives decrease revenue to Freddie Mac relative to Fannie Mae, they effectively act as a further government subsidy under the conservatorship.

¹² This is mainly attributable to the fact that lower coupon securities are generally backed by loans with lower rates, which are less likely, on a relative basis, to experience refinancing activity because there is less economic benefit for the borrower.

prepayment activity, and this becomes clear when you compare recent Fannie Mae and Freddie Mac programs. For example, when HARP 1.0 was introduced in 2009, Fannie Mae eliminated its existing streamlined refinance program and channeled all eligible streamlined refinances through HARP. Freddie Mac, on the other hand, kept its streamlined refinance program intact until April 2012, enabling loans that were ineligible under HARP to remain eligible under its proprietary streamlined program.¹³ In addition, Freddie Mac's version of HARP 1.0 was in some ways more effective than the HARP program under Fannie Mae. Ultimately, these differences in Fannie Mae and Freddie Mac refinance programs resulted in a higher prepayment speed on loans underlying Freddie Mac PCs than those underlying Fannie Mae MBS, which contributed to the current pricing differential. Uniformity of these programs occurred under HARP 2.0 and we have seen prepayment speeds converge as a result.¹⁴

2. Liquidity

The agency market is extremely liquid due to a substantial amount of outstanding and new-issue securities as well as a sizable and active secondary trading market. On a relative basis, however, Freddie Mac PCs enjoy less liquidity than similar Fannie Mae MBS. The expense and uncertainty associated with trading in Freddie Mac MBS due to their lesser liquidity than Fannie Mae MBS has greatly contributed to the current pricing differential. Freddie Mac PCs' liquidity concession results from both greater volume of outstanding and new-issue Fannie Mae MBS and substantially larger daily trading volume for Fannie Mae MBS.

The difference in new-issue volume between Fannie Mae MBS and Freddie Mac PCs has always existed, with approximately 60% of new conforming mortgage originations being traditionally sold to Fannie Mae and 40% being sold to Freddie Mac. However, as noted in the ASF Discussion Paper, there has been a recent shift in originators' loan sales from Freddie Mac to Fannie Mae, resulting in less volume for Freddie Mac PCs. For example in 2011, Freddie Mac issuance dropped to approximately 34%, which is its lowest annual share since Fannie Mae and Freddie Mac began issuing in the same year.¹⁵ For the first ten months of 2012, Freddie Mac's aggregate share of purchases is approximately 34%, well below the historical share of 40%.¹⁶ Freddie Mac's decreasing share of issuance volume further amplifies the liquidity concession already inherent in such securities and hurts investor confidence in the product generally, setting up a potentially self-perpetuating loop where a decrease in investor confidence leads to further

¹³ See Amherst Mortgage Insight, "Fannie/Freddie Price Spreads—BUY Golds," August 17, 2012 ("[Amherst Research Piece](#)"), at 5-6, www.americansecuritization.com/WorkArea/DownloadAsset.aspx?id=7973.

¹⁴ See Amherst Research Piece at 5-8.

¹⁵ By principal balance. Amherst Securities Group.

¹⁶ Freddie Mac's share of new issuance by principal balance for the first ten months of 2012 was approximately 34%, 39%, 31%, 37%, 28%, 39%, 31%, 32%, 29% and 41%, respectively. Amherst Securities Group, Fannie, Freddie, 1010Data.

reductions in price, which may lead lenders with the ability to sell to either Fannie Mae or Freddie Mac to sell fewer loans to Freddie Mac.

The difference in trading activity became clear in October 2011, when the Financial Industry Regulatory Authority (“FINRA”) released TRACE data showing Freddie Mac PCs with a disproportionately smaller share of trading volume. For 2012, this trend has continued with the average daily TBA trading volume of Freddie Mac PCs and Fannie Mae MBS being approximately 10.3% and 89.7%, respectively.¹⁷ The difference in trading activity is not proportionate to the difference in issuance volume, so other factors are at play, including that Fannie Mae MBS are the preferred vehicle for hedging. A primary purpose of the TBA market is to allow originators to hedge the risk associated with interest rates changing from the time that the originator extends a fixed-rate mortgage to a borrower, until the loan is sold to an investor. An originator achieves this by selling or shorting agency securities (of the same category as the originated loan) to hedge the interest-rate risk associated with the loan origination.

The decreasing issuance amount and smaller trading volume of Freddie Mac PCs may disrupt the TBA market’s efficient hedging mechanism, as loan originations intended for delivery to Freddie Mac cannot be efficiently hedged with Freddie Mac PCs, due to their associated liquidity risks and expense. An originator will estimate, based upon their production pipeline, approval rate and other metrics, the amount of securities needed to hedge the loans being delivered into TBA. Because the TBA market is a cheapest to deliver market, if that estimation is wrong, and the originator has to cover the difference between the origination amount and the short, the originator has the ability to purchase securities on the open market to cover the entire amount of the short. At that point in time, the originator becomes subject to the liquidity risk associated with Freddie Mac PCs, as they may find it difficult to cover, or will have to pay a significant liquidity premium to cover, the short through purchasing additional Freddie Mac PCs. In today’s market, Fannie Mae MBS is more efficient, and widely preferred, for hedging interest rate because it does not suffer from the liquidity issues of Freddie Mac PCs.

The trading activity gap has also been bolstered by the fact that Freddie Mac PCs represent a larger share of collateralized mortgage obligation (“CMO”)¹⁸ issuance than their overall share of total issuance. Since 2005, Freddie Mac issuance has been approximately 38% of total issuance and 54% of CMO issuance, leading to a lower tradable supply of Freddie Mac PCs than what is actually originated.¹⁹ Similarly, the trading activity gap would likely widen further if the current issuance trend continues, and even fewer Freddie Mac PCs are available to trade relative to Fannie Mae MBS.

¹⁷ Amherst Securities Group, based on TRACE data.

¹⁸ A CMO is a structured mortgage-backed security that distributes payments and prepayments of mortgage principal across a number of different tranches in a prescribed order. Cash flows from agency securities are often pooled and structured into CMOs.

¹⁹ Amherst Securities Group, Bloomberg, Fannie, Freddie.

B. Enterprise Risk Sharing Securitizations

ASF also fully supports the use of the single securitization platform for risk sharing transactions by the Enterprises in which a portion of the credit risk is transferred to capital markets participants. From the outset, however, it is important to note that once the Enterprises depart from a fully guaranteed model and offer credit risk, the investor base will shift from rates investors to credit investors. Credit investors in an Enterprise risk sharing transaction will likely seek many of the same protections as those sought by investors in PLS. Some of these protections are more fully described below. The two structures being considered by FHFA also raise concerns in the context of TBA eligibility and certain proposed regulations.

With regard to risk sharing transactions by the Enterprises, as noted in the White Paper, it is intended that the single platform be able to support Enterprise securitizations where all securities evidencing a direct interest in the mortgage pool are fully guaranteed, but where some of the first loss credit risk is transferred to private sector credit enhancers, in addition to Enterprise securitizations in a senior/subordinate format (“Senior/Sub”) where non-guaranteed subordinate first loss classes evidencing a direct interest in the mortgage pool are issued to investors. As to the former option, one format that could be used that would permit ready transferability of risk to capital markets participants, while at the same time allowing all securities evidencing a direct interest in the pool to be fully guaranteed by the respective Enterprise, is a synthetic securitization (“Synthetic”) in which credit linked notes issued by a special purpose entity are sold to investors, the proceeds of which are held in pledged accounts, and the entity issues a credit default swap to the Enterprise, whereby if losses are incurred on the reference pool of mortgage loans up to certain limits, funds in the pledged account are paid to the Enterprise.

The Senior/Sub structure may not produce TBA eligible securities for a number of reasons. As to the subordinate classes, these classes would not meet TBA guidelines because they are not guaranteed. Moreover, we anticipate that prospective investors in these securities may insist on receiving detailed loan-level data prior to purchase, or at a minimum would require robust disclosure of pool characteristics including stratifications, which in either case would not be consistent with how the TBA market currently operates. This also raises the question of whether the loan-level data required by investors in the subordinate classes was provided on a confidential basis or was made public. If provided on a confidential basis, an unintended consequence could be that investors in the subordinate classes could be restricted from trading in the senior classes in order to comply with securities law prohibitions on trading on the basis of material non-public information, or alternatively that internal firewalls would need to be created within an institution to comply with these prohibitions (which may not be practical in some cases, particularly for smaller investors). This in turn could restrict the investor base for the subordinate classes and/or the senior classes.

TBA eligibility guidelines may need to be revised in order to accommodate the senior classes in a Senior/Sub structure. Generally in Senior/Sub transactions, there are cash flow provisions that have the effect of delaying the distribution of principal to the subordinate class, in order to preserve the availability of the subordination during the initial years of the transaction. As a result, the senior class does not receive a simple pro rata share of principal collections, and the timing of cash flows to the senior class is affected by these provisions as well as by the rate and timing of losses on the loans. Therefore, it is possible that investors in the senior classes may also insist on receiving more extensive pool characteristics disclosure than is currently provided in the TBA market. In this regard, consideration should be given as to whether senior class investor requirements for extensive pool characteristics disclosure could be met, from a timing perspective, in a manner consistent with existing TBA market forward delivery practices. Alternatively, if as discussed above the loan-level data required by investors in the subordinate classes were to be made public, then investors in the senior classes would have access to that information prior to settlement. In that event, consideration should be given as to whether the availability of loan-level data after pricing but prior to settlement would interfere with the operations of the TBA market as to the senior classes.

In contrast, under the Synthetic structure, the fully guaranteed RMBS would be very similar to those currently issued by the Enterprises because the structure does not impact the guaranteed securities in any way, and should therefore continue to be TBA eligible. However, investors in the credit linked notes may insist on receiving detailed loan-level data or robust disclosure of pool characteristics. As discussed above, the question would be whether this information was provided confidentially or publicly. For the same reasons discussed above, if provided confidentially, securities law requirements could result in a limited investor base for the credit linked notes. However, providing the information publicly would be less likely to interfere with TBA eligibility for the guaranteed securities, as compared to the Senior/Sub structure, particularly if the credit linked notes are issued at some point after the issuance of the guaranteed securities.

These risk sharing transactions may also give rise to potential challenges with respect to currently proposed regulations. During the conservatorship and under the risk retention rules as proposed, fully guaranteed RMBS issued by Fannie or Freddie will be exempt from risk retention. Moreover, as to such securities, the proposed premium capture cash reserve account (“PCCRA”) and the prohibition on hedging will not apply. As a result, during conservatorship, the Synthetic approach could be exempt from risk retention, because the securities evidencing interests in the pool would be fully guaranteed, and the hedging prohibition would not prohibit entering into the credit default swap. However, the Senior/Sub approach would raise difficult issues under the risk retention rules as proposed, as the exemption for the Enterprises would not apply because the subordinate class would not be guaranteed, and also would not count towards the risk retention requirement. Thus, there might be a preference for using the Synthetic

approach. Post conservatorship, the Enterprises would be subject to the normal set of risk retention rules, and would have to retain credit risk in one of the formats prescribed under the rules, none of which are satisfied by either the Senior/Sub or Synthetic approach. Of course, in all cases if the entire pool consisted of “qualified residential mortgages” (“QRM”), then risk retention would not be required. However, unless that definition is expanded substantially from the proposal, most loans securitized by the Enterprises will not meet that definition.

It is also important to consider the potential application of the Securities and Exchange Commission’s (the “SEC”) Regulation AB (“Reg AB”), as well as the SEC’s proposed revisions to Reg AB (“Reg AB II”) that will add robust new loan-level data disclosure and reporting requirements to publicly offered, non-exempt mortgage-backed securities. In addition, the SEC has proposed to extend disclosure and reporting requirements that apply to publicly offered transactions, to any “structured finance products” (“SFP”) that are offered under Rule 144A. While the loan-level proposals are very likely to be adopted, it is somewhat less certain that the latter proposal would be adopted. Under the Senior/Sub approach, the senior securities would continue to be exempt securities; however the subordinate classes would not be exempt securities. If the SFP proposal is adopted and if the subordinate classes were offered under Rule 144A, they would be considered SFP and be subject to Reg AB and Reg AB II. Under the Synthetic approach, the credit linked notes would also be considered SFP, and if the SFP proposal is adopted, it would be necessary to engage with the SEC staff as to what the applicable disclosure and reporting requirements would be (because these types of securities are not addressed in Reg AB or Reg AB II).

The Basel III liquidity framework could have an adverse impact on the Senior/Sub structure as well. Under the proposed liquidity coverage ratio, banking organizations will be required to hold enough high-quality liquid assets to defease their projected net cash outflows for 30 days in a stressed economic environment. While the particular assets that may comprise this liquidity buffer in the U.S. have not yet been specified, the eligibility criteria identified in the Basel Accord include (1) a large, deep and active repo or cash market, characterized by a low level of concentration, for each asset and (2) a proven record of each asset being a reliable source of liquidity in repo or cash markets even during stressed market conditions. Agency debt and agency securities are likely to satisfy these criteria, but whether senior guaranteed securities under the Senior/Sub structure would qualify is less certain. If they do not, we would expect demand to be muted in risk-sharing transactions.

Regarding the Synthetic approach, it would also be necessary to address the issue of whether the issuing entity was a “commodity pool” under Commodity Futures Trading Commission (“CFTC”) rules. The interpretative relief obtained by ASF from the CFTC on October 11, 2012²⁰ would not apply because the credit linked notes would not squarely meet the exemptive

²⁰ See <http://www.cftc.gov/ucm/groups/public/@lrlattergeneral/documents/letter/12-14.pdf>.

criteria in that letter. Ideally, there would be a clarification from the CFTC that vehicles that issue credit linked notes such as those contemplated under the Synthetic approach are not “commodity pools” (and not just that no person is obligated to register as a commodity pool operator), so that transaction parties would not have to comply with commodity pool operator regulations and these vehicles would not be considered “covered funds” under the regulations to be promulgated implementing the Volcker Rule.

Under either approach, it may be advisable to consider some structural changes from fully guaranteed Enterprise securitizations that do not involve risk sharing. Without the benefit of a full Enterprise guarantee and its effective backing by the federal government, investors would likely require some of the protections, controls and additional disclosures that would be provided in a PLS transaction. For example:

- An independent trustee. In PLS, an independent trustee takes ownership of the mortgage loans, and through an independent custodian takes possession of the related mortgage files.
- Master servicer oversight. In some PLS transactions, an independent credit risk manager or operating advisor is engaged for the purpose of monitoring key servicing decisions.
- Representation and warranty enforcement. PLS transactions are evolving in the direction of providing mechanisms to better ensure that breaches of representations and warranties will be discovered, and to provide more certainty with respect to enforcing a repurchase obligation. These mechanisms are quite different than those used in fully guaranteed Enterprise securitizations, because of the fundamentally different nature of the relationships among the parties in a PLS transaction. (See Section II.C.3. below)
- Loan-level data. Investors in the subordinate classes in a Senior/Sub structure, or in the credit linked notes in a Synthetic structure, will likely require the type of robust loan-level data that is provided in a PLS transaction.
- Pre-issuance due diligence. Investors in the credit risk of either structure may require that an independent party conduct due diligence on the underlying mortgage pool prior to the securitization.

II. Comments Related to Private Label Securitizations

A. Reasons for Slow Pace of PLS Market Recovery

The White Paper states that “there does not yet appear to be a significant amount of private capital to provide mortgage credit in scale” and that “the absence of any meaningful secondary mortgage market mechanisms beyond the Enterprises and the Government National Mortgage Association impedes the transition to a post-conservatorship secondary mortgage market.”²¹ While we agree with the former statement, we do not agree with the latter. The PLS market held a significant portion of the securitization market leading up to the crisis, and while certain of its mechanisms are correctly being retooled, the basic framework for a PLS market still exists. Instead, the lack of a vibrant PLS market results from other factors, which are still being resolved and are not addressed by the single securitization platform. In this section, we articulate some of the primary reasons for the slow pace of the PLS market recovery. While we describe each of these reasons individually, it is important to note that it is the confluence of these factors that have inhibited, and continue to inhibit, a vibrant PLS market. As such, resolving some of these issues, but not all of them, may not fully achieve the desired result.

We often hear the view expressed that the Enterprises’ market share must remain high, because private capital is not yet ready to enter the housing finance market. We believe, however, that there is a strong possibility that, at least in part, the reverse is true – that the factors that maintain the Enterprises’ high market share are some of the same factors that are keeping private capital out of these markets.

A major factor is simply that Enterprise transactions represent better execution than PLS transactions. This results in part from the level of the guarantee fees that are paid to the Enterprises on their securitizations. In 2011, guarantee fees averaged 28 basis points, and guarantee fees increased by an average of 10 basis points effective November 1, 2012. Guarantee fees may have to be further increased in order to make Enterprise execution more comparable to PLS execution. The conforming loan limit may also be considered for reduction, such as to the current minimum limit of \$417,000, which would push more mortgages out of the Enterprise market and into the PLS market. High conforming loan limits curtail the availability of loans for the PLS market, in particular because current economics heavily favor Enterprise execution. Additionally, the availability of mortgage credit continues to improve, such that higher conforming limits in high cost areas may no longer be necessary to assure access to credit. Historically, prime quality loans in high cost areas, above the nationwide conforming loan limit, were an important source of loans that attracted capital into the PLS market. Finally, continued uncertainty with respect to the future of the Enterprises makes it difficult for private market

²¹ White Paper at 9 and 4.

participants to determine the extent to which PLS may play a role in the future U.S. mortgage market.

Another significant impediment is the uncertainty surrounding the adoption of final rules relating to ability-to-repay, risk retention, Reg AB II and Basel III, as discussed in detail below. ASF is very concerned about the cumulative effect of regulatory uncertainty on the return of the PLS markets. In order for the PLS markets to return, market participants must be able to assess the risks and benefits of investing capital in developing the platforms and infrastructure that will be needed to support PLS issuance. A substantial capital investment is required for a sponsor to put into place the capability to issue PLS: personnel must be hired, policies and procedures must be developed, sources of loan originations must be developed, and for public issuances, a shelf registration statement must be prepared, filed and declared effective by the SEC. These types of steps are needed in order to demonstrate that there is capacity for issuance of PLS as a secondary market funding source. If these steps cannot be taken, then lenders will be less motivated to invest the capital needed for them to increase originations of mortgage loans earmarked for PLS. Regulatory uncertainty makes it more difficult to invest capital, because it makes it more difficult to be confident of a reasonable return on capital. For example, how can a decision be made to set up a jumbo prime origination or securitization program, when there is no clarity around the QRM definition, and therefore no certainty as to whether risk retention or possibly PCCRA will apply? Even though these rules will apply prospectively only, this uncertainty affects capital deployment decisions now because return on capital, which is projected over an extended time period, cannot be determined or even estimated. For these reasons, setting up a full scale securitization program remains difficult, even though certain securitizers may find economic benefit in a transaction on a one-off basis.

While the ability-to-repay rules will apply to loans included in both private label and Enterprise securitizations, there is substantial uncertainty around the definition of “qualified mortgage” (“QM”), including whether the definition may operate with a safe harbor rather than a rebuttable presumption. This determination will greatly impact the economics of a potential securitization, as these two options provide starkly different levels of protection for lenders and investors in QMs. Further, if the definition sets rigid DTI or LTV standards, or otherwise casts a small net, some qualified borrowers will inevitably be excluded, which may greatly impact the potential universe of loans that can be securitized. These and other considerations are more fully described in our qualified mortgage comment letters that were previously submitted to the Bureau of Consumer Financial Protection (“CFPB”).²² Depending on the outcome of these provisions, the final ability-to-repay rules could have a significant depressing effect on mortgage

²² See http://www.americansecuritization.com/uploadedFiles/ASF_Comments_on_QM_7_22_11.pdf for our initial QM letter and http://www.americansecuritization.com/uploadedFiles/ASF_QM_Comment_Letter_7_9_12.pdf for our supplemental QM letter.

originations, and this is a significant part of the regulatory uncertainty facing the residential mortgage markets today.

One of the most significant sources of regulatory uncertainty for securitization is the risk retention rules, which particularly affect PLS for a number of reasons. First, because the exemption for QRM as proposed is very narrow and because it imposes the full 5% required retention on any pool that contains a single non-QRM, it may result in cliff effects in pricing. Second, the PCCRA aspect of the proposal remains under consideration, and potentially brings with it fundamental changes to securitization economics. Third, PLS competes directly with the Enterprises for the residential securitization market, and the Enterprises have a complete exemption from the risk retention requirements, including PCCRA, for fully guaranteed issuances. For these reasons, the risk retention proposal creates uncertainty for PLS. These and other considerations are more fully described in our risk retention comment letter.²³

There is also uncertainty around the exact provisions of the final Reg AB II rule, although it will most likely add to the complexity and expense of a publicly offered PLS transaction due to increased disclosure and reporting burdens. It is also possible that Reg AB II requirements will be extended to PLS offerings under Rule 144A as well.²⁴ None of these proposed requirements will apply to fully guaranteed securities issued by the Enterprises, although as discussed above they would apply to the subordinate classes in a Senior/Sub structure and the credit linked notes in a Synthetic structure.

Furthermore, the proposed rules to implement Basel III capital standards in the U.S. create additional regulatory uncertainty with regard to capital requirements for banks holding residential mortgage loans or PLS. It is unclear how “category 1” loans will be defined for purposes of comparatively more favorable capital treatment for such loans as well as PLS backed by them. Moreover, due to moving away from a ratings based approach to setting risk weights for non-government backed securitization exposures, the capital cost to banks of holding PLS is unclear, and the disparity in capital requirements between PLS and Enterprise securitizations is likely to widen. These and other considerations are more fully described in our Basel III comment letter.²⁵

Additional proposed regulations that affect PLS, and for which the timing of finalization is uncertain, include CFPB regulations governing residential mortgage loan servicing, as well as SEC regulations mandated by Dodd Frank that will substantially increase required disclosures by credit rating agencies and possibly increase the costs of ratings. PLS, unlike Enterprise

²³ See http://www.americansecuritization.com/uploadedFiles/ASF_Risk_Retention_Comment_Letter.pdf, for our risk retention comment letter.

²⁴ See <http://www.americansecuritization.com/uploadedFiles/ASFRegABIICommentLetter8.2.10.pdf>, for our Reg AB II comment letter.

²⁵ See <http://www.americansecuritization.com/WorkArea/DownloadAsset.aspx?id=8342>, for our Basel III comment letter filed on October 22, 2012.

securitizations, in most cases depend on ratings from credit rating agencies. More broadly, rating agencies have been very methodical in developing new and improved procedures and methodologies for ratings of PLS, which has increased the costs and lengthened the timelines in launching new issues. The relatively low volume of new issuances of rated PLS also means that the universe of current and recent performance information is relatively small, which may contribute to more conservative assumptions and higher required enhancement levels.

Finally, there are macroeconomic forces in play that have slowed the return of the PLS markets. High unemployment and low GDP growth rates have limited the demand for housing credit by borrowers that meet today's more conservative underwriting standards, and for the most part this low level of origination volume can be filled by the Enterprises (especially given the relatively low guarantee fees and the high conforming loan limits) as well as by bank balance sheet capacity. This limited demand, as well as the Federal Reserve Bank of New York's purchase program for Enterprise securitizations and the availability to banks of low interest rate deposits, explain why mortgage loans funded through PLS channels are currently at extremely low levels. Prevailing market rates may not be sufficient to support the high costs of launching and servicing a PLS issuance. These factors act to keep private capital away from the PLS market while at the same time preserving a high market share for Enterprise securitizations.

B. Industry Efforts to Restart PLS

FHFA makes observations in the White Paper with respect to the legal framework for PLS, which are intended to highlight areas that could be improved through creation of the single platform. In particular, the White Paper states that (i) "[t]he lack of standardization in the many versions of Private Label PSAs produced divergent business practices that led to ambiguity in interpretation," (ii) investors were "affected by non-standardized loan representations and warranties and ineffective mechanisms for enforcing remedies for breaches of representations and warranties" and were unable "to identify and communicate with other investors" and (iii) there was a "lack of information about the performance of mortgage loans in the securitization."²⁶ It is important to consider these statements in light of (x) the nature of the PLS market and the reasons why terms and contractual provisions differ, and (y) the substantial work that the industry has undertaken over the last 5 years to create model practices and standards for private label securitization in these same areas.

The PLS and agency markets are inherently different. The offering of a guarantee and the related exemption under the federal securities laws enable the Enterprises to dominate and standardize the structure, governance and disclosure of Agency MBS transactions. However, if the guarantee is eliminated and credit risk is sold, the incentives among transaction parties shift, and individual determinations of contractual and securities law liability as well as the simple

²⁶ White Paper at 12-13.

process of negotiation result in non-standard transactions that have differences in structure, governance and disclosure. For these reasons, which are more fully described in Section II.C., while FHFA is correct in that standardization in certain areas would be helpful in the PLS market, it is important to understand that such a goal will inherently have limits.

It is also important to consider that private label market participants have endeavored to create standardization and best practices through ASF's Project on Residential Securitization Transparency and Reporting ("Project RESTART" or the "Project"),²⁷ which began in late 2007 as an industry-developed initiative to help rebuild confidence in mortgage-backed securities and restore private capital flows to the securitization markets. Project RESTART has sought to identify areas of improvement in the process of securitization and refashion, in a comprehensive and integrated format, the critical aspects of securitization with market-based solutions and expectations. The areas targeted by Project RESTART in 2007 substantially overlap with the areas identified by FHFA as concerns in the White Paper, including standardized disclosure and reporting, bond reporting and further standardization of the PSA. FHFA should consider the industry work completed in these areas before attempting to fashion solutions as part of the single securitization platform.

Our work to date on Project RESTART, with a wide variety of stakeholders in the PLS markets including issuers, investors, financial intermediaries, trustees, servicers, rating agencies, professional firms and service providers, none of whom have the power to unilaterally set standards and practices, has made it clear to us that these markets are very dynamic. On any given topic, there are many different viewpoints and opinions among the various market participants. Consensus is only achieved over time through an iterative process, and its implementation in new transactions evolves over time. In the following sections, we provide an overview of the various phases completed through Project RESTART. We would very much appreciate the opportunity to meet with FHFA in the future to provide additional information or insight, as needed.

1. ASF Disclosure and Reporting Packages

On July 15, 2009, ASF released final versions of the first two deliverables of the Project, a disclosure package of loan-level information to be provided by issuers prior to the sale of PLS transactions (the "ASF Disclosure Package") and a reporting package of loan-level information to be updated on a monthly basis by PLS servicers throughout the life of a PLS transaction (the "ASF Reporting Package").²⁸ Both of these packages increase and standardize critical data at issuance and throughout the life of a transaction, which will enable investors to better perform deal and loan-level analysis on the basis of the credit quality of the underlying mortgage loans.

²⁷ For more information on Project RESTART, see www.americansecuritization.com/restart.

²⁸ For more information on the Disclosure and Reporting Packages, see [www.americansecuritization.com/uploadedFiles/ASF Project RESTART Final Release 7 15 09.pdf](http://www.americansecuritization.com/uploadedFiles/ASF%20Project%20RESTART%20Final%20Release%207%2015%2009.pdf).

ASF continues to believe that standardized loan-level disclosure is a critical step to bringing private capital back to mortgage securitization. In connection with the packages, Project RESTART also created a unique loan identification number, known as the ASF LINC™, to facilitate the monitoring of a mortgage loan throughout its life, from origination through securitization. Finally, Project RESTART envisioned that the information included in the ASF Disclosure and Reporting Packages would be aggregated in an industry data repository that would enable a gateway between market participants and an individual loan and borrower's characteristics.

This phase of Project RESTART has been utilized extensively by regulators and legislators over the past two years, as they have proposed many of the same items that ASF recommended. In April of 2010, the SEC proposed Reg AB II, which includes loan-level PLS disclosure and reporting proposals that were substantially based on the work done in Project RESTART. Three months later, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank"), which specifically calls for issuers of asset-backed securities to disclose "asset-level or loan-level data, if such data are necessary for investors to independently perform due diligence."²⁹ The SEC has since clarified that their Reg AB II proposals fulfill the loan-level mandate set forth in Dodd-Frank. Additionally, the Governing Council of the European Central Bank ("ECB") has been preparing since December 2010 to implement loan-level data reporting requirements for ABS, which will become mandatory for various asset classes over the course of the next several years.^{30,31} Finally, on November 1, 2012, FHFA and the CFPB announced that they would partner to create a National Mortgage Database, containing a comprehensive collection of detailed loan-level information to be updated monthly.³²

While much of what the SEC proposed in Reg AB II was consistent with the ASF Disclosure and Reporting Packages, ASF submitted detailed comments to resolve certain inconsistencies.³³ We are hopeful that the SEC incorporates our comments into the final rule. The potential assimilation of the ASF Disclosure and Reporting Packages with the SEC's Reg AB II proposal provides a substantial impetus for FHFA to model the single platform disclosure after those PLS efforts. Certainly, multiple disclosure regimes would not be helpful for lenders, issuers or investors.

²⁹ See Title IX, Subtitle D "Improvements to the Asset-Backed Securitization Process" at <http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf>.

³⁰ See <http://www.ecb.int/press/pr/date/2012/html/pr120706.en.html>.

³¹ See <http://www.ecb.int/mopo/assets/loanlevel/transmission/html/index.en.html>.

³² See <http://www.fhfa.gov/webfiles/24621/NMDFHFACFPB110112F.pdf>.

³³ See <http://www.americansecuritization.com/uploadedFiles/ASFRegABIICommentLetter8.2.10.pdf>, for our Reg AB II comment letter.

2. ASF Model Representations and Warranties

The next phase of Project RESTART sought to bring standardization and transparency to the representation and warranties included in PSAs. The type and form of representations and warranties in past transactions varied greatly, and investors desired greater transparency in the provision of representations and warranties across issuers. On December 15, 2009, ASF released a model set of representations and warranties for PLS transactions (collectively, the “ASF Model Representations and Warranties” or the “Model Reps”)³⁴ to more clearly allocate origination risks between issuers and investors and provide enhanced investor protections over what had been previously provided in “pre-crisis” transactions. The Model Reps seek to allocate these risks in light of the originator’s ability to monitor, process and verify critical borrower and loan information. The Model Reps enable investors to more easily and better assess the allocation of origination risk in a given transaction by making the provision of representations and warranties more comparable and transparent. We also note that the SEC leveraged the Model Reps in creating Rule 17g-7, which requires a credit rating agency to issue a report describing how the representations and warranties for a rated PLS differ from typical representations and warranties for that asset type.

3. ASF Model Repurchase Provisions

Many investors believe that the repurchase process set forth in pre-crisis securitization contracts did not provide applicable parties with an adequate means to pursue a repurchase demand nor did it effectively specify mechanisms to identify breaches or resolve a question as to whether a breach occurred. In the beginning of 2011, our membership began working towards model repurchase principles (the “ASF Model Repurchase Principles”)³⁵ to delineate a consensus framework for enforcing remedies with respect to representations and warranties in PLS transactions. The ASF Model Repurchase Principles were released on August 30, 2011 and establish, among other things, the role of a new “independent reviewer” that will have access to the files of applicable mortgage loans to determine if a breach has occurred and a robust mechanism for the investigation and resolution of disputes regarding breaches of transaction representations and warranties. Key provisions of the ASF Model Repurchase Principles include the independence of the independent reviewer from the pre-issuance due diligence provider and any transaction party, clear disclosure of the events that will trigger review, a prescribed method for the independent reviewer to obtain access to the mortgage files, a mechanism for investor communication to facilitate removal of the independent reviewer and a binding arbitration process to resolve disputes. Some of the elements of the ASF Model Repurchase Principles were

³⁴ For more information on the ASF RMBS Model Representations and Warranties, *see* [www.americansecuritization.com/uploadedFiles/ASF Project RESTART Reps and Warranties 121509.pdf](http://www.americansecuritization.com/uploadedFiles/ASF_Project_RESTART_Reps_and_Warranties_121509.pdf).

³⁵ *See* <http://www.americansecuritization.com/WorkArea/DownloadAsset.aspx?id=6545>.

incorporated into the re-proposed conditions for shelf eligibility for asset-backed securities proposed by the SEC.³⁶

4. ASF Bond-Level Reporting Package

On November 10, 2009, the ASF released for comment the proposed ASF Bond-Level Reporting Package (the “ASF Bond-Level Reporting Package”),³⁷ which consists of data fields that provide enhanced and standardized reporting of bond-level information throughout the life of a PLS transaction. It was envisioned that the bond information contained in the ASF Bond-Level Reporting Package would be integrated with the loan-level information contained in the ASF Disclosure and Reporting Packages through a link created between the CUSIP for each bond and the industry-wide loan identifier, the ASF LINC™. This linkage would enable investors and rating agencies to easily acquire information about the specific loans underlying a particular bond.

C. Reasons Why Enterprise Single Platform May Not be Suitable for PLS

FHFA has made clear in its presentations of the White Paper that it does not intend, nor does it have the authority, to mandate that the PLS market embrace the single securitization platform. However, the White Paper does envision that the single securitization platform could potentially be utilized by the PLS market,³⁸ and FHFA has indicated that the platform could potentially be transferred or sold to the private market as a public utility after the Enterprises exit conservatorship. Furthermore, the risk sharing transactions discussed above bring about issues that also exist in PLS, as part of the structure would be sold to investors without a guarantee. For these reasons, ASF believes that a description of how PLS securitization differs from Enterprise securitization will hopefully be helpful to FHFA as it proceeds in developing the single platform.

1. Wholesale Standardization Conflicts With PLS Market

Our work with the industry in connection with Project RESTART since 2007 confirms our belief that while there is a need and desire for model standards and practices that focus on specific topics, such as loan data fields and representations and warranties, wholesale standardization of offering and governing documentation for PLS is likely not feasible. If credit risk is sold rather than guaranteed, the incentives among transaction parties shift, and individual determinations of

³⁶ See <http://www.sec.gov/rules/proposed/2011/33-9244.pdf>. The re-proposed conditions provide for (1) the appointment of an unaffiliated “credit risk manager” to review pool assets for compliance with transaction representations and warranties, (2) a dispute resolution mechanism involving mediation or arbitration if the obligated party does not repurchase the relevant assets after demand and a specified time for investigation and (3) a mandatory mechanism to facilitate direction of trust actions by investors, which reflects the same philosophical approach underpinning the ASF Model Repurchase Principles.

³⁷ For more information on the ASF RMBS Bond-Level Reporting Package, see www.americansecuritization.com/uploadedFiles/ASFProjectRESTART_RMBSTrusteeRFC_Nov2009.pdf.

³⁸ White Paper at 24.

contractual and securities law liability result in non-standard transactions that have differences in structure, governance and disclosure. There are simply too many moving parts for a “one size fits all” set of disclosure and operative documents to be effective.

That said, we would describe the documentation process differently than the White Paper, which indicates that a “typical Private Label PSA is created on a highly customized basis for each MBS transaction.” While Private Label PSAs may appear to be highly customized when comparing one issuer’s PSA to another issuer’s, as to any given issuer most of the customization occurs at the inception of their issuance program, for example when filing a shelf registration statement with the SEC or when issuing the first transaction. Once an issuer has launched its first series, revisions to the PSA used in follow-on transactions are generally done on an incremental basis, such as for changes in structure or transaction parties.

2. Need for Flexibility in Private Label PSAs

Following are some specific reasons why variations may exist between private label PSAs.

At the outset, we note that not all PLS are issued using PSAs. Some are issued in the form of notes under an indenture, either with or without a REMIC election. Reasons for this format include: a) the pool would be REMIC eligible, but would not meet the criteria for the ERISA exemptions that apply to pass-through certificates and therefore must be issued as notes to assure eligibility for investment by ERISA plans, or b) the securitization is being issued by a real estate investment trust (“REIT”) through a qualified REIT subsidiary, which must issue in a non-REMIC debt for tax structure in the form of notes in order to comply with limits on gains for tax purposes.

Credit enhancement, an issue not faced in fully guaranteed Enterprise securitizations, is a major driver of variances among PSAs. Provisions governing internal subordination are very complex, and vary from program to program. In some cases, reserves need to be established for specific purposes. In transactions where external (or third party) credit enhancement is used, the PSA requires very substantial revision to integrate the credit enhancement into the cash flow, and to provide certain rights and provisions that are required by the credit enhancer.

Swaps are generally used in PLS transactions where the loans are ARMs and the securities pay a floating rate based on LIBOR. Swaps are also sometimes used with fixed rate loans, where the securities are tied to LIBOR. We understand that Enterprise securitizations generally do not include swaps. Incorporating swaps into a PLS transaction is a significant cause for variances among PSAs, not only due to the resulting structural changes, but also because another party with different incentives is being brought into the transaction.

Varying loan types also create differences among PSAs. PLS transactions that include ARMs have significantly different cash flow provisions related to interest distributions, as compared to

fixed rate pools. Additionally, PLS transactions involving non-performing loans will have different tax provisions and different representations and warranties than transactions involving performing loans.

Representations and warranties may vary among PLS to a significant extent, which is a major difference from Enterprise securitizations. Going forward, we anticipate more standardization as to presentation of and the specific language used for representations and warranties, based on the Project RESTART Model Reps, or on specific language required by credit rating agencies. We note that Rule 17g-7 now requires a credit rating agency to issue a report describing how the representations and warranties for a rated PLS differ from typical representations and warranties for that asset type, so that standardization of presentation and language are desirable for an efficient ratings process. However, none of this means that the PLS industry will move to an across the board “one size fits all” set of representations and warranties. This was well understood during the Project RESTART process, where the goal was to create transparency in the representation and warranties process, not to require all issuers to use the same representations and warranties. Issuers and underwriters will continue to negotiate the specific representations and warranties that will be given under any program.

Another aspect of PLS that creates variances relates to representations and warranties by prior holders. In Enterprise securitizations, only the seller/servicer makes representations as to the loans. But frequently PLS are issued not by originators, but by conduits, REITs and other aggregators who purchase loans from originators. In these transactions, the issuer generally makes some representations and warranties, but it may also assign to the transaction the representations and warranties that were made by the originators. These provisions are quite complex, and detailed aspects of these provisions are evolving significantly in transactions currently taking place. Additionally, a backup representing party may be put into place if the primary is deemed by investors to have inadequate capability to fulfill loan repurchase duties.

Another area where there are significant variances among transactions relates to the use of special servicers, which take over servicing from the servicer upon certain events, such as a specified period of delinquency, or additional parties such as credit risk managers or operating advisors who are charged with monitoring servicing decisions. Furthermore, in transactions where there is a master servicer as well as one or more servicers, provisions under which the master servicer delegates to and oversees the servicers may vary from transaction to transaction, and in the current environment these provisions are evolving in new transactions and may continue to do so. These are also areas where there is no corollary in Enterprise securitizations.

Varying terms may also be required by investors, particularly where the first loss classes are structured for specific investors. In these circumstances, the investor may require “controlling certificateholder” provisions that provide control rights over certain servicing decisions and other actions.

Also, whenever a new transaction party is added to an existing program, such as a new trustee or servicer, the party may seek to negotiate new provisions relating to matters such as duties, liabilities and indemnities.

Regulations that apply to PLS, but do not apply to the Enterprises as to fully guaranteed securities, are an important reason why PSAs for private label transactions will likely continue to be different from any form of PSA that may be developed in connection with the single securitization platform. Under existing Reg AB, for publicly offered RMBS transactions, the PSA must contain provisions designed to assure compliance with applicable Exchange Act reporting requirements. One such requirement is the Reg AB Item 1122 “assessment of compliance” that requires gathering reports from various parties participating in the servicing function. There are also requirements for various parties to submit information relating to events that would trigger a Form 8-K filing. Recent PSAs include language to facilitate compliance with new Rule 15Ga-1 regarding activity relating to breaches of representations and warranties. And, when Reg AB II or other applicable regulations are finalized, new PSAs will need to incorporate appropriate language addressing any new requirements.

3. Representation and Warranty Enforcement Mechanisms

A major topic on which there are substantial variances among PSAs used in recently issued PLS is representation and warranty enforcement mechanisms. We expect these variances to persist in the future as PLS market participants continue to refine these provisions in the context of launching new transactions.

Representation and warranty enforcement is fundamentally different in PLS as compared to the Enterprises, because there is no corollary in the PLS market to the relationship between Fannie or Freddie and a given seller/servicer. Fannie and Freddie each have enormous negotiating power relative to a given seller/servicer by reason of: ability to withdraw seller/servicer eligibility, ability to unilaterally set Guide terms, sheer magnitude of the mortgage loan purchase relationship, and the powers that result from being able to offer the best execution for conforming loans. Mechanisms are not needed to assure that representations and warranties will be appropriately enforced by the Enterprises; to the contrary, if any change is needed in this regard it is to give sellers more certainty about the limits around representation and warranty enforcement, and changes are being made by the Enterprises in this direction.

With PLS, the imperatives around enhanced enforcement mechanisms are fundamentally different. A seller to a PLS trust does not face a party providing a guarantee, but instead a special purpose trust with multiple stakeholders that is represented and serviced by entities with limited powers. Experience from the last few years shows that major improvements, including those recommended in Project RESTART (discussed above), are needed for PLS governing documents to assure that representations and warranties will be properly enforced. But the

nature of the fixes needed for PLS is fundamentally different than the types of enforcement mechanisms that would appear in an Enterprise single platform PSA.

There are two different approaches for representation and warranty enforcement that are being developed and implemented in the PLS market. One approach is the one advocated by ASF as part of Project RESTART, elements of which also have been added to the Reg AB II proposal as part of the re-proposed shelf eligibility criteria. Under this approach, the PSA would be hard-wired with triggering events that mandate a review of loans by an independent reviewer to determine whether breaches of representations and warranties occurred, and also would include specific enforcement mechanisms if there is a dispute as to whether there was a breach, including binding arbitration if necessary.

Another approach is similar to a concept used in CMBS, whereby the first loss holder is designated as a “controlling certificateholder” that has certain types of discretion over determining breaches and enforcing remedies. This approach is well suited to a PLS issuer that aggregates mortgage loans from unaffiliated originators, with a view towards securitization as a form of term financing and towards retention of the first loss classes.

Additional issues that are being considered by PLS market participants, and that are being resolved and implemented in some transactions, are sunset provisions for representation and warranty remedies, provisions that require that certain breaches contributed to a loss in order for a remedy to apply, and provisions that treat other specified breaches as deemed to be material and to trigger a remedy.

Improvements in representation and warranty enforcement provisions are critically important in order to restore investor confidence in new issue PLS. Provisions used by the Enterprises would not be as effective in the PLS markets. Private label market participants must be free to develop industry best practice provisions on this topic, and this is a key example of why an Enterprise single platform PSA would likely not translate well to the PLS market.

4. Disclosure and Securities Law Liability; Issuer Role

The White Paper contemplates that the single platform could produce standardized disclosures for investors.³⁹ While this approach is feasible in the agency market, which is exempted from the general securities law framework, it would not work under current disclosure and liability standards governing the PLS market.

Issuers of publicly offered PLS are subject to strict liability under Section 11 of the Securities Act, and underwriters as well as other persons have liability subject to due diligence defenses. Issuers, sponsors and sellers of publicly offered PLS may also have liability under Section

³⁹ White Paper at 25.

12(a)(2) of the Securities Act, subject to due diligence defenses but with the burden of proof on the defendant. Liability also arises under Rule 10b-5 as to Rule 144A and other private offerings, and as to all offerings liability also may arise under applicable state securities and other laws. These liability standards are not compatible with a PLS sponsor or issuer relying on an independent “platform” or “utility” to create disclosure documents. All parties with due diligence defenses must take necessary steps to assure the accuracy and completeness of the disclosure, and reliance on automatically generated disclosures from an unaffiliated source would likely not meet that standard.

Performing due diligence for a publicly offered PLS issuance is an arduous process that must be fully performed for each transaction. Participation is needed from inside and outside counsel, accountants, independent asset review services, and many individuals within the issuer and offering participants. Due diligence procedures are also required as to disclosures about transaction participants, such as originators and servicers. All of these functions are also overseen by risk management teams within the key offering participants.

A specific articulation of this standard is now found in Rule 193, which requires that the issuer undertake a review to provide “reasonable assurance” that the disclosure about the pool assets is accurate and complete. Again, reliance on an unaffiliated platform to create the disclosure may not provide this reasonable assurance.

The following provides illustration of this point. Hypothetically, if a private sector entity were developing a securitization issuance platform for PLS of the type contemplated in the White Paper, that entity could not reasonably be expected to provide indemnification to any PLS user of the platform for any securities law liability resulting from using disclosures generated by the platform. It is equally difficult to expect PLS issuers and other offering participants to use disclosures generated by such a platform without controlling the creation and dissemination of those disclosures to an extent that would undercut the utility of producing them via the platform.

Even if PLS market participants were willing to use disclosures generated by the single platform, consideration should be given as to whether the single platform and its controlling persons themselves had direct liability for the disclosures under the Securities Act, by reason of the degree of involvement in the issuance process that is contemplated by the White Paper.

For these reasons, we have a strong fundamental view that the issuer role in a PLS transaction is not a “service” in the same sense that activities such as master servicing and bond administration can be considered to be a service or utility function. Being a PLS issuer is much more akin to a principal role, which as discussed above, is subject to very substantial regulation under the federal securities laws and other laws, and for which significant potential liabilities attach. PLS issuers need to have substantial control over applicable disclosure documents, and all operative documents must be subject to negotiation and editing during the drafting process.

5. Risk Retention

Another key area where PLS securitization documents in the near future will differ from Enterprise documentation relates to risk retention. Although it is not clear when these rules will be finalized or how they will be changed from the proposal, the proposed risk retention rules may be indicative of what the final rules will be. As discussed above, during the conservatorship period, fully guaranteed securities of the Enterprises will be exempt from risk retention, and as to risk sharing transactions, if the Synthetic approach is used, the credit linked notes would also be exempt. If the Synthetic approach is favored, then we believe it is quite possible that the Enterprise single platform PSA will not need to contain any provisions related to risk retention during the conservatorship period.

In contrast, PSAs for private label transactions will of course have to comply with the final risk retention rules once effective. For transactions not fully exempt based on the QRM rules, there will be a number of alternative forms for risk retention including horizontal slice, vertical slice, L-shaped and representative sample. There will be prohibitions on transfers and hedging, and there may be PCCRA. Thus, these new rules will give rise to many additional differences between PSAs for PLS and those for the Enterprises.

6. Distinct Seller and Servicer Roles

Another major difference in PSA documentation between PLS and the Enterprises results from the fact that Fannie and Freddie require that the roles of seller and servicer be linked, whereas in private label transactions those roles are separate. Fannie and Freddie both require that the loan seller, which is the entity responsible for the representations and warranties made as to the loans, be the same party as the servicer of the loans. In the event of a servicing transfer on loans in an outstanding Enterprise securitization, the successor servicer is generally required to assume liability for the representations and warranties.

In contrast, most private label PSAs are deliberately structured so that the seller and servicer role are distinct. Even where the same entity initially is both seller and servicer, the defined terms “seller” and “servicer” are used throughout the document to denote which rights and responsibilities belong to the servicer and therefore would apply to a successor servicer. And the PSA contains express provisions governing servicing transfers that allow a transfer of servicing free of the seller’s liabilities under its representations and warranties.

Private label PSAs also frequently contain provisions designed to facilitate advance facilities, which are credit facilities provided by banks to servicers to help them fund advances for delinquent borrower payments as well as servicing advances. These provisions are designed to give the lender a security interest in the servicer’s reimbursement rights under the PSA, and to address issues such as setoff and the order in which advances are reimbursed. These concepts

are addressed only on a negotiated basis by Fannie and Freddie, and we would not expect to see standard provisions to facilitate advance facilities in an Enterprise single platform PSA.

These features of private label PSAs promote the free transferability of servicing to a successor servicer who meets specified criteria. It is widely anticipated that the Basel III regulations in the U.S. will make it more difficult for banks to hold servicing rights on their books, which will make the ready transferability of servicing rights even more important going forward.

7. Absence of Seller/Servicer Guide in PLS

A further major difference between PLS and Enterprise securitization documentation is the absence of a corollary to a seller/servicer guide in the private label markets.

Our understanding is that the single platform PSA contemplated in the White Paper will be a short form PSA that includes an addendum for lender-specific requirements, supplemented by the applicable seller and servicer guides. Thus, provisions relating to seller representations and warranties and related remedies, as well as provisions governing all aspects of servicing, would not be in the PSA. These topics constitute major portions of the substantive provisions that are included in a private label PSA.

PLS participants would likely not adopt the Fannie or Freddie guides on a wholesale basis without a substantial incentive to do so. PLS participants have more equality of bargaining power, and less counterparty exclusivity, than applies in the context of Enterprise securitizations. Generally, documents similar to a seller or servicer guide are not used in the private label markets.

In addition, we anticipate that servicing standards and practices in the private label markets will increasingly be governed and defined by regulations promulgated by the CFPB. This trend may undercut any policy argument that could be made in favor of imposing Fannie or Freddie servicing standards on PLS through operation of the single platform PSA.

8. Public Policy Issues

The Enterprises have been and likely will continue to be used to advance certain broader economic and social policy objectives, in a manner consistent with FHFA's conservatorship mandate. This results in the Enterprises adopting policies and taking actions that would not necessarily be followed by PLS market participants. For example, the Enterprises have engaged in the HARP program, which allows refinancing of loans that have high LTVs at current property values and are owned by, or in a securitization guaranteed by, Fannie or Freddie. This program makes sense from the Enterprises' perspective as it is not detrimental to their existing credit exposure on the loans being refinanced. However, private label market participants may not provide refinancing on these terms. Another public policy issue currently under discussion is

the use of eminent domain by local authorities to seize non-delinquent but underwater mortgage loans, in order to facilitate a short refinance. While FHFA has issued a notice and request for comment on this topic that expresses concern about possible losses to taxpayers resulting from such application of eminent domain to loans owned by or in securitizations guaranteed by the Enterprises, it is not known what position FHFA will ultimately take on this issue. While public policy goals may be a worthy objective of a government entity, their promotion through the single platform might be inconsistent with private market participants' interests and the functioning of the capital markets.

9. Anticompetitive Effect

Finally, the White Paper indicates that master servicing, bond administration and possibly trustee functions would be performed through the single platform. It is unclear what role, if any, existing entities that perform these services would have, but it does appear that there would be no provision for freedom of choice among potential service providers in engaging these services. We believe that this may have undesirable anti-competitive effects. As in any other business, the various entities that currently offer master servicer, bond administration and trustee services are able to compete for market share by offering better service and/or lower prices. In view of all of the other headwinds facing PLS market recovery, removing the benefits of competition in providing these services would be a further detriment.

D. Lack of Incentives for Use of Single Platform for PLS

Finally, it is unlikely that the securitization platform as proposed in the White Paper provides sufficient incentives for PLS issuers to use the platform, and investors to participate.

Fully guaranteed Enterprise securitizations have important inherent advantages that would be compatible with the new platform. The presence of the guarantee, with its effective federal backing, mitigates many of the concerns that investors have with respect to PLS. This in turn will allow for the degree of standardization of PSAs and disclosures, structures and procedures, for Enterprise securitizations, that must be present for the proposed securitization platform to operate efficiently. In this context, standardization is an advantage.

In contrast, for the reasons discussed above, wholesale standardization of PSAs and disclosure is not an advantage for PLS because it would impair the ability of issuers to meet their objectives, and would impair the ability to deliver to investors rights, protections and disclosures that they desire. Thus, wholesale standardization in the PLS context may, in fact, be a disincentive for issuers to use the platform, for which there is no countervailing incentive. As we learned through our efforts with Project RESTART, while there is a need and desire for model standards and practices that focus on specific topics, such as loan data fields and representations and

warranties, wholesale standardization of offering and governing documentation for PLS is simply not feasible or desirable.

Furthermore, fully guaranteed Enterprise securitizations are exempt from registration, disclosure and reporting requirements under the federal securities laws. This allows for a high degree of standardization of PSAs and disclosure under the proposed platform, which is needed for it to function efficiently for these types of securities. But PLS using the platform will not be exempt from Reg AB or Reg AB II, or from potential liability under the federal securities laws. As discussed under Section II.C.4. above, PLS issuers must retain substantial control over the issuance, disclosure and reporting process in order to fulfill their obligations under the securities laws and to satisfy their duties to investors. Wholesale standardization of disclosure under the proposed platform will not be possible as long as potential liability under the securities laws exists.

While cost savings could potentially be an advantage that would be an incentive for PLS issuers to use the platform, cost savings alone may not be enough to induce issuers to use the platform if such savings are outweighed by constraints on an issuer's ability to deliver to investors the protections and disclosures required in a dynamic PLS market or to effectively manage securities law and contractual liability risks.

Finally, it is possible that some future form of government sponsored enterprise ("GSE") involvement in the housing markets could create incentives for PLS issuers to use the single platform. For example, some current proposals contemplate a hybrid structure, under which a PLS issuer could purchase a GSE guarantee on the senior portion of a mortgage pool, using a risk sharing structure to sell the first credit loss into the capital markets. In such a structure, the senior securities might be exempt under the Securities Act, mitigating the concerns discussed above about using the single platform. However, a host of other important questions must be considered before these types of transactions came to pass, including the ownership structure of the platform.

* * * * *

ASF Comment Letter re FHFA White Paper

December 3, 2012

Page 30

ASF very much appreciates the opportunity to provide the foregoing comments. Should you have any questions or desire any clarification concerning the matters addressed in this letter, please do not hesitate to contact me at 212.412.7107 or at tdeutsch@americansecuritization.com, Evan Siegert, ASF Managing Director, Senior Counsel, at 212.412.7109 or at esiegert@americansecuritization.com, Jim Johnson, ASF Managing Director, Public Policy at 202.664.6081 or at jjohnson@americansecuritization.com or ASF's outside counsel on this matter, Stephen Kudenholdt of SNR Denton at 212.768.6847 or at steve.kudenholdt@snrdenton.com.

Sincerely,

A handwritten signature in cursive script that reads "Tom Deutsch".

Tom Deutsch
Executive Director
American Securitization Forum

EXHIBIT I





